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Free Press' Assessment of and Recommendations to Improve
The Commission's Draft ICC-USF Reform Proposal

Below we offer our opinions on the Commission's Draft Proposal and recommendations for improving the plan in a manner that is consistent with the public interest principles of the Communications Act. We must stress that the recommendations we offer here are bound by the framework of the current Draft Proposal. That is, were we starting from scratch and working in a world free of path-dependency, we would likely offer a substantially different-looking package of reform policies. However, it is clear that idealism is not a luxury we can afford at this point. We are choosing to participate constructively in this process in an effort to minimize the burden that this reform package will place on consumers, and to ensure that these policy changes result in substantial long-term benefits for all consumers.

Improving the ICC Reform Elements of
The Commission's Draft Proposal: Terminating Access Rates

At its core, the ICC reform elements of the Commission's Draft Proposal results in a very-low terminating access rate that is uniform among all carriers within a given state. We fully support the notion that the price of terminating a call should not differ based solely on the arbitrary regulatory classification of the carriers involved in the transaction, nor should it differ based on the calls geographic origin.

However, this does not mean that we should throw the cost-based principles of the Act out the window. If a proper forward-looking cost study demonstrates a real difference in call termination cost between certain exchanges, then a unified rate across all calls fails to adhere to the cost-based principles of Section 252 and is economically inefficient. However, it may be the case that the transaction costs associated with a varying (but cost-based) rate structure exceed the efficiency gains from having cost-based rates. It is plausible that a unified rate structure reduces transaction costs and discourages arbitrage opportunities at a level that outweighs the efficiency losses and equity concerns of a unified rate. This is a central question that must be addressed.

Thus, we recommend that the Commission establish a framework that drives terminating access rates lower, but relies on the states to decide the issue of where the final rates should land. Thus, working within the structure of the current Draft Proposal, state regulators would establish a process where rates would decline in years 1 and 2 to the current interstate level; in years 3, 4 and 5 they would decline further to a carrier-specific, cost-based reciprocal compensation rate. The states would then decide whether or not to move to a unified forward-looking reciprocal compensation rate across all carries over the following 5-year period. We envision that in the November 4th Report and Order, the Commission puts a firm rule on the years 1 and 2 process, and seeks input on the implementation for years 3-10.

This approach to shaping the path to lower rates should address many of the concerns of the non-RBOC carriers, who don't dispute the need for a lower rate, but are opposed to a uniform $0.0007 rate.

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Improving the ICC Reform Elements of
The Commission's Draft Proposal: Subscriber Line Charge Increases

A central feature of the Commission's Draft Proposal is a $1.50 increase in the Subscriber Line Charge (SLC), to a maximum of $8.00 per primary residential line, and to $11.50 for business lines. The Commission has the statutory authority to impose Subscriber Line Charges to recover the portion of loop costs placed in the interstate jurisdiction. Thus, in the Draft Proposal, we have increases in the SLC designed to offset reductions in all terminating access charges -- both inter-and intrastate.[5]

SLCs are appropriate if they do not result in an over-recovery of costs. However, we are concerned that the current SLCs charged by carriers already result in an over-recovery of costs on a substantial portion of lines, and any further increases -- while offsetting access charge reductions -- could result in an even greater level of over-recovery. When the Commission adopted the current $6.50 SLC cap in the *CALLS Order*[6] it ruled that a further cost review proceeding would have to be undertaken in order to determine if SLCs should rise above $5.00. Specifically, the Commission stated that in this cost review proceeding it would "examine, forward-looking cost information associated with the provision of retail voice grade access to the public switched telephone network."[7] When the review proceeding was concluded, it became apparent that very little verifiable actual forward-looking cost information had been submitted to the Commission.[8] In the June 2002 *Order*, the Commission ruled that the $6.50 cap was reasonable, despite the conclusion that approximately 82 percent of residential and single-line business price-cap lines had forward-looking costs below $6.50.[9]

Therefore, we would prefer that the Commission revisit this issue in a comprehensive manner prior to implementing any SLC increases. However, we recognize the high likelihood of the Commission acting as it did in the *CALLS Order*, where it ordered an immediate SLC increase. If the

5 Because of this, the Commission must be explicit as to why this particular SLC increase is allowed under current law. *See* 47 U.S.C. §§ 4(i), 201-205; see also *National Association of Regulatory Utility Commissioners v. Federal Communications Commission*, 737 F.2d 1095, 1114 (D.C. Cir. 1984) (NARUC v. FCC).
6 *Access Charge Reform,* Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000) (*CALLS Order*), *aff'd in part, rev'd in part, and remanded in part, Texas Office of Public Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied, Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 70 U.S.L.W. 3444 (U.S. Apr. 15, 2002).
7 *Ibid.* ¶ 83
8 In his dissenting statement, Commissioner Michael J. Copps stated, "[a] significant number of carriers, however, submitted summary data without disclosing the inputs used, cost models that were not transparent, or in some cases, models that have been rejected by the state commissions... The Commission then failed to conduct its own independent analysis of the cost data. By failing to undertake the thorough analysis of cost data that was promised in the access reform order, we are neglecting our obligation to consumers."
9 See footnote 82, *In the Matter of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers,* CC Docket Nos. 96-262, 94-1, Order, FCC 02-161, rel. June 5, 2002.

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Commission is determined to act in this fashion, we have several recommendations that will mitigate consumer harm.

First, given that the Draft Proposal calls for a phase in of access rate reductions, there should be a commensurate phase in of SLC increases. There is absolutely no reason why LECs should be permitted on day one to charge a full $1.50 in additional SLCs when they have not experienced *any* declines in access revenues. If the Commission is adamant that a $1.50 SLC increase is appropriate while the Federal-State Joint Board (FSJB) considers the issue of a national rate benchmark, then the Commission needs to provide some justification of how this $1.50 increase relates to reduced access charges, and phase in the SLC increase commensurate with the access charge decreases.

For example, in a recent *ex parte,* AT&T provides some estimates of the potential access shifts resulting from a move to a "recip comp proxy" to be $2.3 billion per year.[10] They also estimate that there are 81 million primary residential lines. Thus, under this scenario a SLC increase of $1.50 results in an offset of $1.46 billion annually from primary residential lines alone (we can also assume a substantial additional offset revenues from the increase in the multi-line business SLC from $9.20 to $11.50 -- perhaps as much as $1.1 billion annually).[11] But the full force of the $2.3 billion in annual access revenue reductions resulting from a decline to a "recip comp proxy" won't even be felt for many years -- potentially 10 years.

Why then should SLCs increase now? Plainly, they shouldn't. If they do, it should be very little while the access charges are phased down. Thus for example, if the phase down of access charges in year one results in a $500 million annual access shift, then the SLC increase for primary residential and single-line businesses should be no more than 25 cents.[12]

Therefore we request that in addition to delegating to the FSJB the issue of determining a national rate benchmark and final SLC cap, that the Commission, in the forthcoming Report and Order and Further Notice, begin a cost-review proceeding to determine the proper level for SLCs, based on forward-looking cost models that are detailed and transparent (and available for public review under cover of confidentiality).

We also strongly recommend that the Commission determine the net access shift that will result from a reduction in access rates to interstate levels by the end of year two of the ICC transition plan. We then recommend the Commission calculate the appropriate temporary SLC increase (for these

10 *Ex Parte* communication of AT&T, Re: *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *High-Cost Universal Service Support*, WC Docket No. 05-337; *Universal Service Contribution Mechanism*, WC Docket No. 06-122; *Intercarrier Compensation for ISP-Bound Traffic*, WC Docket 99-68; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, October 20, 2008.
11 The Commission estimates there were about 40 million multi-line business lines that companies reported as qualified to receive Subscriber Line Charges in 2006, and another 9.7 non-primary residential lines. See Table 1.3 in "Trends in Telephone Service", Industry Analysis Division, August 2008.
12 Here we assume 86 million SLC-qualified primary residential and single line business lines, 9 million non-primary residential lines, and 40 million multi-line business access lines. Based on the current ratios of the residential-to-multi-line SLCs ($6.50/$9.20 = 0.7), the increase in the multi-line business SLC under this scenario would be about 40 cents per month.

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two years) based on this amount of access revenue shift (minus any imputed to vertically integrated LECs; see below) -- and that this SLC increase be itself phased in over the two year period. The Commission ***must*** approach the initial SLC increases in this fashion, for if it does not it is harming consumers by saddling them with plainly unjustifiable SLC increases. This method of parallel phase-in (access charges declining as SLC charges increase) represents a fair and reasonable way to ensure that the burden of regulatory change is shared and not borne disproportionately by rate-payers.

Our second recommendation is based upon the principle of fairness. We feel that the Commission must recognize the massive changes that have occurred in the telephony industry since it last undertook access charge reform in 2001. Since then, vertical integration between RBOCs, IXCs and wireless carriers has nearly reconstituted the former Ma Bell monopoly. Verizon and AT&T dominate the local exchange, long-distance and mobility markets. Their respective long-distance and wireless businesses will benefit substantially from the lowering of access charges. While it is true that the LEC side of their businesses will have declines in access revenues, it is a safe assumption (based on their eagerness for the Commission to lower access rates) that they stand to reap substantial net benefits from ICC reform.

Therefore we strongly urge the Commission to only allow a carrier to increase their SLCs if they can show their business experiences a net decline in revenues as a result of ICC reforms. Thus, wireline customers of AT&T and Verizon should not be subjected to SLC increases unless those carriers are able to demonstrate net access revenue declines as well as rates that are below the benchmark set by the FSJB. In the event of such a showing, the increases should proceed on the parallel phase-in method described above.

Improving the ICC Reform Elements of
The Commission's Draft Proposal: Access Recovery from USF

The other major feature of the Commission's Draft Proposal -- and most other ICC reform proposals -- is an Access Recovery Fund (ARF) for carriers who do not recover all of their revenue declines in increased SLCs. The reasoning here is that access charges contain an implicit universal service subsidy for high-cost carriers. However, there is no evidence whatsoever that the amount in ARF needed to "make a carrier whole" is in any way related to the amount of implicit USF support contained in access revenues. Therefore we are strongly opposed to any reform proposal that attempts to play a zero-sum-game.

The Commission must be guided by the Act. Universal service support should be explicit, and sufficient enough to ensure reasonably comparable rates. It should not be excessive. In this light, we remind the Commission of the wild range various parties attributed to the implicit USF component of price cap carrier interstate access charges in the CALLS proceeding. Some claimed the amount was as high as $3.9 billion annually, while others claimed a low of $250 million. The Commission ultimately settled on a value of $650 million -- a number suggested by industry and not calculated by the Commission. This pool of Interstate Access Support (IAS) was due to be reevaluated after 5 years, with acknowledgement that the $650 million amount might be excessive

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after that time.[13] This never happened, despite the fact that interstate access minutes have declined some 40 percent since then, and despite the fact that technology costs have continued to decline.

The Commission's Draft Proposal would establish an ARF for rate of return carriers that would amount to a maximum of $200 million to $300 million per year. This pool of funds would be incorporated into the current program to offset reductions in interstate rates paid to rate-of-return carriers -- the Interstate Common Line Support program (ICLS). It is not clear to us what this $300 million in increased ICLS ARF is based upon. If it is the total amount that rate-of-return carriers will need to be "made whole" after a SLC increase, then it is an inappropriate deviation from the cost-based and sufficiency principles of the Act.

Under the Commission's Draft Proposal, price-cap regulated carriers will not be able to access this pool of money without first making a cost-showing (though we're uncertain as to how this would actually be structured; e.g. would a carrier have to "open the books" on all revenue and cost streams, or merely on the regulated side of the business). We support this approach, and believe it should apply to all carriers, including rate-of-return carriers. However, we understand the concerns the Commission has in regards to triggering potential confiscation claims by rate-of-return regulated carriers (though we still feel a cost-showing is appropriate in all cases).

Because the increased ICLS ARF will not be made available to price-cap carriers, the Commission must be cognizant of how this will impact these businesses. A quick look at the bottom line net profit margins (NPM) and Return on Equity (RE) of several major mid-size price cap carriers (i.e. non-vertically integrated RBOCs) reveals that most of these companies are already fairing better than the average for this industry sector (which is approximately 9.6 percent NPM over the past 5-years and a 11.9 percent RE over that time). Take for example the carrier Windstream. Their 5-year average NPM is above 17 percent, nearly two times the industry sector average. Windstream's 5-year average Return on Equity is 50.2 percent, nearly five times the industry sector average. At the other extreme is a company like Fairpoint Communications, whose 5-year average NPM is 2.5 percent, with a 5-year average RE of 16 percent. Also worth noting is the fact that many of these carriers have long-distance business segments that stand to reap substantial access charge savings.

Since many of the price cap regulated companies earn returns far higher than the 11.25 percent for rate-of-return carriers, is it fair for USF funds to be awarded to these companies to offset revenue losses from reductions in above-cost access charges -- revenues that are in a natural free fall as a result of changing market conditions? Is it fair for these USF funds to be locked in and awarded in perpetuity despite the fact that the returns of many of these companies would still remain well above the industry sector average even in the absence of additional USF support?

These companies chose the path of price cap incentive regulation -- a path that has rewards and risks. Thus, merely requiring them to show a true need of additional explicit subsidies for the purposes of universal service seems reasonable. After all, price cap carriers are generally less reliant than rate-of-return carriers on access revenues and are also able to take advantage of

13 Supra note 6, at ¶203.

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economies of scale, unlike smaller RoR carriers.

However, we must avoid punishing the customers of these companies, and therefore must provide a "safety net" -- not necessarily in the form of access recovery funds, but in a one-time path back to rate-of-return regulation. Thus we propose the Commission establish a forbearance mechanism for distressed price cap companies to violate the "permanent choice rule" and return to rate-of-return status.[14] However, to avoid the enriching that the permanent choice rule was originally established to prevent, the rate-of-return allowed for a carrier exercising this option should be substantially lower than 11.25 percent.

Ultimately, we recommend that any new access recovery funds be based on forward-looking cost estimates, even ARFs for rate-of-return carriers. The current ICLS funds available to rate-of-return carriers are based on embedded costs[15], despite the fact that the Commission has previously concluded that "universal service support for all carriers should be based on the forward-looking economic cost of constructing and operating the network used to provide the supported services, rather than each carrier's embedded costs".[16] When the Commission created the ICLS, it concluded that it was appropriate to base this support on embedded costs, but that this issue would be revisited in 5-years. Like the promise to revisit IAS, this never happened.

We also recommend that as a part of the Further Notice issued in this proceeding, the Commission seek input on the continued need for locking in "frozen" implicit access revenue subsidies even as access minutes are in rapid decline. We proffer that the current $650 million in IAS (established in 2000) and the current $1.5 billion in ICLS (established in 2001) are far in excess of actual need. The Further Notice should concur with this conclusion, and seek input on a phase down and eventual termination of these programs -- offset if needed with explicit broadband infrastructure support.

Improving the USF Reform Elements of
The Commission's Draft Proposal: Broadband

The Commission's Draft Proposal requires all USF-supported carriers to deploy broadband, at a minimum level of 768 kbps, to 100 percent of their service areas within a 5-year period. Carriers are required to cover their unserved areas at a rate of 20 percent per year over the 5-years. If the USF-supported carrier fails to meet this obligation, the area is put up for a reverse auction, with the

14 47 CFR 69.3(i)(4).
15 Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Fifteenth Report and Order; Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, Report and Order, Prescribing the Authorized Rate of Return From Interstate Services of Local Exchange Carriers, CC Docket No. 98-166, Report and Order, 16 FCC Rcd 19613, FCC 01-304 (2001) (*MAG Order*); at ¶125.
16 MAG Order at ¶56 referencing Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 9164-65 (1997).

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reserve bid price set at the current study area per-line support level.

While we support modernizing the fund by incorporating broadband, we have serious concerns about the practical outcomes of this particular proposal.

First, we don't envision any non-rural carrier being able to meet their 100 percent obligation at the current level of support (which for most of these carriers consists of only minimal High-Cost Model (HCM) support and IAS support for geographically large study areas). We also don't envision other providers showing up to the reverse auction and meeting the reserve bid. This is simply because many of the non-rural study areas are geographically massive, such as the old Pac Bell study area which consists of 14 million access lines.

In these situations with no bidder, there is no improvement in broadband deployment from the status quo. This is what we call the "dead-end" scenario. Because carriers in such study areas face no penalties from failure to meet the 100 percent broadband deployment benchmark, they have no incentive to deploy based on the current level of support. Furthermore, even in study areas where a non-incumbent bidder wins the reverse auction, there's a high-likelihood that USF monies will be used to build or maintain broadband infrastructure in locations where other unsubsidized services already exist. This outcome would result in an unnecessary use of scarce resources.

The "dead-end" scenario is a very likely outcome. It is worth noting that no carrier has publicly stated that they will be able to meet the Draft Proposal's 100 percent benchmark at current support levels; and we should assume that this silence means that they cannot or will not.

If the Commission is determined to adopt a USF reform plan similar to that in the Draft Proposal, then we recommend the following changes.

First, the Commission should not use a specific speed benchmark of 768kbps. Instead, the standard should be service speeds and qualities (i.e. latencies) that are reasonably comparable to those available in that particular state.[17] This standard should also be flexible for the small portion of homes that are defined as "extremely high cost" (see next item). We recommend this issue be addressed in the Further Notice.

Second, the Commission should recognize that a very small percent of homes might be prohibitively expensive to serve. In this instance, the cost of serving the last one percent of unserved homes could dwarf the other 99 percent. Thus we recommend the Commission establish a case-by-case forbearance process where these extremely high-cost homes can be served using alternative technologies such as fixed wireless or satellite. The Commission should seek input in the Further Notice as to what the cost-differential should be in order to qualify for forbearance. A reasonable value may be on the order of 5 to 10 times the current average per-line cost for a given study area.

17 The issue of latency is perhaps just as important as speeds. While some satellite broadband offerings may have speeds that exceed 768kbps, the latency of these services results in a user experience that is far different from those using low-latency technologies.

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Third, carriers should be required to offer buildout plans once a year for the 5-year period leading to 100 percent service deployment. If a carrier does not meet or does not plan to meet its obligations in any of the 5-years, then the auction process should commence immediately. Thus, if from day zero a carrier declares they cannot meet the buildout requirements, then the auction process should begin.

Fourth, in order to avoid the "dead-end" scenario describe above, if a study area is put up for reverse auction and receives no winning bidders, then the study area should be disaggregated. We recommend disaggregation into Census Block Groups (CBGs). Then, using the new Form 477 availability data (that we and others have urged the Commission to collect in a separate proceeding)[18], the Commission should identify the CBGs within a particular study area that are not served by any broadband provider.

Once the served and unserved areas of a study area are identified, the Commission or a state Commission should then designate a current broadband provider in the served portions of the study area as the Carrier of Last Resort (COLR). If there is one or more USF-supported broadband providers and one or more unsubsidized broadband providers in these served portions of a study area, then the unsubsidized provider should be designated by the Commission or state Commission as the COLR, either based on authority under Section 214(e)(3) of the Act or by negotiation. This newly designated COLR will not be eligible for USF support absent a showing of need (and need will be based on the cost of providing broadband and voice-grade service at retail rate reasonably comparable to the statewide average).

The USF monies that were previously distributed to the COLR in these served portions of the study area will then be redirected to supporting broadband in the unserved portions of the study area. The unserved portions of a study area will be bid out in a request for proposal (RFP) process, with a general cost-guideline used instead of a reserve bid (i.e., support will not be bound by the current POTS per-line support amount, recognizing that these areas will require increased USF support).

The scheme proposed in the above paragraphs is a carrot-and-stick approach that we believe will provide substantial incentives for current USF-supported carriers to meet the original 100 percent buildout obligations in order to avoid a "dead-end" first round auction and subsequent potential loss of support. This proposal -- by recognizing that many rural areas already have unsubsidized cable broadband service -- efficiently targets resources in the areas where the current USF-supported COLR cannot meet the buildout requirements. It also increases the amount of USF support available in the truly unserved areas by redirecting support away from areas where it is not needed.

We strongly recommend the Commission adopt this disaggregation approach. While we recognize that some carriers may be worried about a net loss in USF support under this approach, we believe

18 See for example Comments of Consumers Union, Consumer Federation of America, Free Press and Public Knowledge, In the Matter of *Deployment of Nationwide Broadband* Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership, WC Docket No. 07-38, July 17, 2008.

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that most rural and non-rural carriers will actually see little net change as a result of a more precise targeting of USF support. If the Commission simply adopts the current Draft Proposal without making these modifications, the end result will be no meaningful increase in broadband deployment and continued misallocation of scarce USF resources.

Improving the USF Reform Elements of The Commission's Draft Proposal: Mobility

The Commission's Draft Proposal caps support for mobile wireless CETCs at the current total level ($1.25 billion annually), but eliminates the Identical Support Rule (ISR). This means that in order for a wireless CETC to continue to receive support, they must participate in a cost proceeding. We are uncertain if this requires a CETC to file part 32 accounting and part 64 allocation documentation, or if the Commission will create a new cost-showing mechanism. However a CETC makes a cost showing, support will not be available unless it substantially exceeds a national benchmark. If no CETC in a study area undergoes a cost showing, the Commission's Draft Proposal designates that area for a reverse mobility auction, with the reserve price set at the lowest total CETC support for that study area. CETCs are required to meet the same 100 percent broadband benchmarks as incumbent carriers.

As supporters of universal affordable communications technologies, we support the idea that rural consumers should have access to mobility services at reasonably comparable qualities and rates. However, the framework established in the 1996 Act does not appear to square with the realities of today's communications marketplace, where mobility services are not in direct competition with wireline services; but are instead complementary services. Under the structure of the Act, if the Commission is forced to make choices on how to allocate scarce resources, we feel that the Act's principles lead the Commission down a path of supporting robust advanced telecommunications infrastructure, which may or may not have a mobility component.

This is why we ultimately think Congress must directly address the issue of a separate mobility support structure. However, in the interim, as the Commission makes changes to the Universal Service Fund, it must ensure a basic level of universal mobile voice service. Thus we recommend that the Commission, during the first year interim transition period, determine the populated areas where no mobile voice service would be available absent USF support. The Commission should then target its mobility funds towards those areas. Thus, if an area is served by one or more unsubsidized mobility providers, then no USF support should be provided in that area (irrespective of a CETC cost-showing). In areas with only unsubsidized mobility providers, support for the lowest cost-carrier should be awarded. And in the areas where no provider currently exists, mobility funds should be targeted for voice-grade infrastructure investments.

While we understand the Commission's desire to fund mobile broadband services, we don't think the case has been made that this is a necessary and efficient use of scarce USF resources. This is ultimately a threshold question that Congress must answer.

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Conclusion

If the Commission makes the necessary changes outlined above, we believe it should move forward and adopt a Report and Order and Further Notice of Proposed Rulemaking at the November 4th open meeting. The question of which elements fall into which item remains open and to be determined by the commissioners. However, we favor a model in which the framework (starting points, end points, principles, and time-table) and initial steps appear in the Order, paired with an FNPRM that contains strong tentative conclusions for implementation and administration.

On the issue of ICC rate reform, the Commission should rule that access rates will be set on a path of reduction, and delegate the decisions about where final rates should land to the states. States should have the flexibility to decide whether the final cost-based reciprocal compensation rate should be uniform across all carriers, or if it is economically appropriate to have some level of variation. A path to an intermediate step of interstate rates over two years can be firmly established in the Order, and the details of the states' implementation process in the years after that can be examined in a Further Notice.

On the issue of SLC increases, we strongly urge the Commission to undergo a cost-review process before implementing any such increases. However, if it does rule that a SLC increase is appropriate while the FSJB decides the issue of a national benchmark, then the SLC increases must be commensurate with the declines in access charges. The Commission **must not** allow an across the board SLC increase of $1.50 in the initial years of the access transition, because this (along with the proposed increase in the business SLC) would result in an immediate offset of the full value of the access shift -- a shift that will not occur for many years. Allowing the full SLC increases in the early years of the transition gives LECs additional revenues that have not yet been lost, and this is simply unacceptable.

If the Commission is intent on immediate changes to the SLC, we urge it to determine the amount of access shift that will occur in the first two years of the transition (as rates go to interstate levels), and only allow SLC increases that offset this access decline. We estimate, based on very crude data, that the SLC increase needed during the first two years would be approximately 20 to 30 cents for primary residential lines. Finally, vertically integrated carriers who will be net beneficiaries of the decline in access charges should not be allowed to increase their SLCs.

On the issue of access recovery funding for the purposes of universal service, we strongly recommend that such funding be based on actual need, not a desire to make a carrier whole. All carriers should be required to quantify the actual amount of implicit support contained within their current access revenues, and then demonstrate this support is actually needed, and is not already offset by off-the-books unregulated revenue streams. If the Commission establishes an additional access recovery mechanism, then the support should be based on a carriers forward-looking cost, and take into account declining access minutes. The Commission should conclude that these new funds, and all access replacement funds will sunset in five years, absent further Commission action. If a price cap carrier cannot or will not make a needs-based cost showing, then a one-time path back to rate of return regulation (at a rate lower than 11.25 percent) should be permitted.

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On the issue of declaring VoIP an information service, we **strongly** urge the Commission to leave this monumental decision to a Further Notice, as this change will completely upend the structure of Section 251 and create massive uncertainty as to the future of the entire industrial interconnection regime. There is simply no interconnection regime under Title I to ensure competitive access. Therefore this move would jeopardize the future of the advanced telecommunications market, something that is in direct conflict with Section 706 of the 1996 Act.

On the issue of universal service reform, we support the Commission's general goal of modernizing the USF to support broadband. But we have substantial concerns that the current framework in the Draft Proposal will not result in much change from the status quo. Indeed, the fact that no carrier has indicated their willingness to meet the 100 percent benchmark outlined in the Draft Proposal is indicative that no such outcome should be expected.

We feel that the reasonable comparability standard of the Act means that a 768kbps standard is arbitrary. A better approach would be to require services that are reasonably comparable those available in other areas within a given state. This, combined with a flexible approach to serving the last few very high-cost customers, will ensure that a substantial majority of consumers in a given study area have access to broadband services that are not of a quality which is years behind that available in urban areas.

We recommend a carrot-and-stick incentive-based approach that leads to study area disaggregation in the instances where there is no winning bidder. Under this approach, current USF funding will be diverted away from areas where broadband services are currently deployed by unsubsidized carriers, to the truly unserved areas.

Ultimately, we feel that the Commission should establish a solid framework in an Order, and issue a Further Notice with strong tentative conclusions that addresses the more difficult implementation issues. This approach is prudent, as many of the implementation details will need to be sorted out over the next year even if the Commission chooses to only issue a Report and Order. Thus many of the details that commenting parties are most concerned about (and are asking for an additional comment cycle on) can be dealt with in the Further Notice. We recommend a 3 to 6 month comment cycle and a 3 to 6 month deliberation cycle, culminating with a final Order on November 4th 2009.

Respectfully submitted,

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By:

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Dated: October 24, 2008

OPASTCO

WESTERN TELECOMMUNICATIONS ALLIANCE

21 Dupont Circle NW
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October 29, 2008

Marlene H. Dortch, Secretary
Federal Communications Commission
Office of the Secretary
445 12th Street SW
Washington, DC 20554

Ex Parte Notice

Re: Developing a Unified Intercarrier Compensation Regime CC Docket No. 01-92

High-Cost Universal Service Support WC Docket No. 05-337

Federal-State Joint Board on Universal Service CC Docket No. 96-45

Dear Ms. Dortch,

Attached is a revised version of an *ex parte* filing made earlier today, with a modification to the second bullet on page two. Specifically, it clarifies that the second component of the supplemental interstate common line support (ICLS) is available only to those rural rate of return-regulated incumbent local exchange carriers (ILECs) that have committed to the five-year broadband build-out requirement.

In accordance with FCC rules, this letter is being filed electronically in the above-captioned dockets.

Sincerely,

Stuart Polikoff
Director of Government Relations
OPASTCO

OPASTCO

WESTERN TELECOMMUNICATIONS ALLIANCE

21 Dupont Circle NW
Suite 700
Washington, DC 20036

October 29, 2008

Marlene H. Dortch, Secretary
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Ex Parte Notice

Re: Developing a Unified Intercarrier Compensation Regime CC Docket No. 01-92

High-Cost Universal Service Support WC Docket No. 05-337

Federal-State Joint Board on Universal Service CC Docket No. 96-45

Dear Ms. Dortch,

On October 28, 2008, H. Keith Oliver of Home Telephone Company, Inc., Mark Gailey of Totah Communications, Inc., Catherine Moyer of Pioneer Communications, Roger Nishi of Waitsfield & Champlain Valley Telecom, Robert DeBroux of TDS Telecom, John Rose and Stuart Polikoff of the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), and Derrick Owens and Jason Williams of the Western Telecommunications Alliance (WTA) held a conference call with Chairman Kevin Martin, his Chief of Staff, Daniel Gonzalez, his Legal Advisor, Amy Bender, and Dana Shaffer and Donald Stockdale of the Wireline Competition Bureau. The purpose of the conference call was to discuss Chairman Martin's draft Order addressing the comprehensive reform of intercarrier compensation and universal service and its potential impacts on rural, rate of return (RoR)-regulated incumbent local exchange carriers (ILECs).

Based on our understanding of the draft Order from our discussion, and subject to any major undisclosed modifications, OPASTCO and WTA support its adoption, provided that at a minimum, the following items are included to address the service areas of rural RoR ILECs.

- Supplemental interstate common line support (ICLS) (i.e., "the restructure mechanism") is automatically available for carriers that are currently under RoR regulation in the interstate jurisdiction without any other conditions applying, particularly those related to the way a carrier is regulated in the state jurisdiction.

- Supplemental ICLS for rural RoR ILECs has two components. The first component compensates rural RoR ILECs for all of the revenues lost as a result of the mandated reductions in intercarrier compensation rates that are not otherwise recoverable through increases in subscriber line charges (SLCs). The first component remains in effect for the entire 10-year transition to the final state-established uniform terminating rates. The second component is available only to those rural RoR ILECs that have committed to the five-year broadband build-out requirement and is intended to ensure that those rural RoR ILECs continue to have an opportunity to earn their authorized interstate rate of return, subject to a cap. This component will provide compensation for unrecoverable revenue losses attributable to losses in access lines and interstate and intrastate minutes of use, using 2008 as a base year. The second component remains in effect for the first five years of the transition and is capped at $100 million in year one, $200 million in year two, $300 million in year three, $400 million in year four, and $500 million in year five. Prior to year five, the FCC shall conduct a proceeding to determine if modifications are required.

- The "Rural Transport Rule" applies to rural RoR ILECs. This means that for local and extended area service (EAS) calls made by a rural RoR ILEC's customer to a non-rural carrier's customer, the rural RoR ILEC will be responsible for transport to a non-rural terminating carrier's point of presence (POP) when it is located within the rural RoR ILEC's service area. When the non-rural terminating carrier's POP is located outside the rural RoR ILEC's service area, the rural RoR ILEC's transport and provisioning obligation stops at its meet point and the non-rural terminating carrier is responsible for the remaining transport to its POP.

- The broadband build-out requirement has a limited automatic exception for very high-cost loops and allows rural RoR ILECs to serve those customers by satellite without filing a waiver request. A very high-cost loop is defined as a loop in which the additional cost to provide broadband is in excess of 150 percent of the carrier's study area average loop cost. The automatic exception cannot apply to more than two percent of a carrier's total loops within a study area.

- All high-cost universal service mechanisms utilized by rural RoR ILECs continue to operate as they do today through 2010. This includes high-cost loop support (HCLS), local switching support (LSS), interstate common line support (ICLS), safety net additive support, and safety valve support. Support from these mechanisms will be frozen by study area at 2010 levels.

OPASTCO and WTA appreciate the opportunity to provide input on behalf of our membership. These issues are vital to our companies and rural consumers. We recognize that reform of intercarrier compensation and universal service is critical at this point in time. Again, with the inclusion of the modifications set forth above, and absent any major undisclosed changes, OPASTCO and WTA support the Chairman's proposal.

Sincerely,

Kelly Woo

John N. Rose, President
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21 Dupont Circle NW
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Washington, DC 20036

Kelly Worthington, Executive Vice President
WTA
P.O. Box 5655
Helena, MT 59604

cc: Chairman Kevin Martin
Commissioner Jonathan Adelstein
Commissioner Michael Copps
Commissioner Robert McDowell
Commissioner Deborah Tate
Amy Bender
Nicholas Alexander
Scott Deutchman
Scott Bergmann
Greg Orlando
Dana R. Shaffer
Julie Veach
Kirk S. Burgee
Donald Stockdale
Marcus Maher
Jeremy Marcus
Randy Clarke
Alexander Minard

October 22, 2008

Marlene H. Dortch, Secretary
Federal Communications Commission
Office of the Secretary
445 12th Street SW
Washington, DC 20554

Re: Notice of *Ex Parte* Communication: WC Docket Nos. 01-92, 04-36, 05-337, 06-122

Dear Ms. Dortch:

CTIA - The Wireless Association® ("CTIA") takes this opportunity to underscore the need for fundamental reforms to the universal service and intercarrier compensation systems so that they better reflect consumer choice and the competitive marketplace. Specifically, CTIA supports: (1) Unification of the intercarrier compensation system, with a uniform termination rate no higher than $0.0007 per minute, as a transition to a bill-and-keep system; (2) Dedicated universal service support for the deployment and maintenance of advanced mobile wireless services in high-cost areas; (3) The establishment of Lifeline and Link Up discounts to enable lower-income individuals to purchase affordable broadband services utilizing the technology of their choice; and (4) A numbers-based universal service contribution system that does not unfairly treat over 44 million wireless prepaid and over 70 million wireless family-plan customers. As the Commission considers how best to implement these changes, CTIA respectfully requests three changes to the draft Report and Order, Order on Remand, and Further Notice of Proposed Rulemaking currently under consideration. Namely, the Commission should:

1. Reduce the proposed transition to unified cost-based rates for traffic termination from ten years, as has been proposed, to five years;

2. Provide a five year transition from support currently provided to competitive eligible telecommunications carriers ("ETCs") under the identical support rule to any successor mechanism(s); and

3. Seek comment on an appropriate universal service mechanism (or mechanisms) focused on the deployment and maintenance of advanced mobile wireless services in high-cost and rural areas.

These changes, while modest, will significantly increase the consumer benefits of the Commission's intercarrier compensation and universal service reform efforts.

First, CTIA supports a five year transition to a unified cost-based rate for traffic termination. There is broad agreement in the record that unification of the intercarrier compensation system is long overdue. Parties agree that the current disparate intercarrier compensation system severely distorts the competitive marketplace and undermines the efficient deployment of next generation voice, data, and video services delivered over broadband capable facilities.[1] According to the Commission, "a regulatory scheme based on these distinctions is increasingly unworkable in the current environment and creates distortions in the marketplace at the expense of healthy competition. Additional problems with the existing intercarrier compensation regimes result from changes in the way network costs are incurred today and how market developments affect carrier incentives. These developments and others . . . confirm the urgent need to reform the current intercarrier compensation rules."[2] The transition to a unified intercarrier compensation system, therefore, should not take another decade to achieve. Instead, CTIA supports a more reasonable five year transition period, which will provide state commissions, as well as impacted carriers and customers more than sufficient time to transition to a modified compensation structure.

Second, CTIA supports the same five year transition period for changes to the high-cost support available to competitive ETCs. The Federal-State Joint Board on Universal service ("Joint Board") suggested such a transition period in its Recommended Decision on high-cost universal service reform.[3] Over a specified period of time, the Joint Board envisioned that wireless ETCs would transition from existing funding sources to a successor Mobility Fund.[4] Wireless ETCs have now invested billions of dollars to deploy wireless facilities in rural and high-cost areas with the expectation that high-cost support will be available to help defray both the initial deployment and ongoing maintenance and operations costs of these networks. Indeed, under the FCC's ETC designation guidelines, the FCC and many states require wireless ETCs to submit and comply with five year build out plans. As the FCC has stated, failure to comply with these build out commitments could result in revocation of an ETC's designation. In the wireline context, the Commission has provided reasonable transition periods for any significant changes in high-cost support amounts. Wireless ETCs, too, should be provided a reasonable transition period. To this end, CTIA supports a five-year period during which wireless carriers are transitioned off of the existing support mechanisms and onto any successor mechanisms.[5]

Third, the Commission should shelve the interim wireless "actual cost" mechanism under consideration and seek comment on a more appropriate high-cost mechanism (or

[1] *See* Letter from AT&T, CompTIA, CTIA, Global Crossing, ITIC, NAM, New Global Telecom, PointOne, Sprint Nextel Corp., TIA, T-Mobile, Verizon, and the VON Coalition to Chairman Martin, Commissioner Copps, Commissioner McDowell, Commissioner Adelstein, and Commissioner Tate, FCC, CC Docket No. 01-92 (filed Aug. 6, 2008). *See also, e.g.,* Comments of National Cable & Telecommunications Association, WC Docket No. 08-160, CC Docket No. 01-92 (Aug. 26, 2008) at 2 ("NCTA consistently has supported rational reform of the intercarrier compensation regime."); Comments of the National Association of State Utility Consumer Advocates to Refresh the Record, CC Docket No. 01-92 (July 7, 2008) at 7 ("NASUCA agrees that the current regime of widely varying rates for the same functionality depending on the type of call and the carriers involved creates opportunities for abuse and arbitrage, and cannot be sustained in the long run. NASUCA therefore also agrees that reform is needed."); Comments of The Rural Alliance, CC Docket No. 01-92 (June 27, 2008) at 7 ("If the Commission believes that the Missoula Plan cannot be adopted at this time, then the Commission should consider simplified, yet still comprehensive intercarrier compensation reform.").

[2] *In re: Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd. 4685 at para. 3 (rel. Mar. 3, 2005).

[3] *See High-Cost Universal Service Support, Federal-State Joint Board on Universal Service,* WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, FCC 07J-4. paras. 27-28 (rel. Nov. 20, 2007) ("*Recommended Decision*").

[4] *Id.* at para. 28.

[5] *Id.* at para. 27.

mechanisms) to permanently replace the identical support rule (if eliminated). Such a mechanism should provide dedicated universal service support for the deployment and maintenance of advanced mobile wireless services in high-cost areas. Initial comments in this proceeding presented extensive data demonstrating that technology and the marketplace have changed in fundamental ways since the current universal service mechanisms were adopted in 1997.[6] These data show that consumers today primarily value mobility and broadband.[7] As Verizon recently observed, an increasing percentage of U.S. households rely exclusively or almost exclusively on their mobile wireless services for their network connectivity and growth in wireless-only households is accelerating (especially in light of a challenging economic outlook).[8] The marketplace developments demonstrate that any universal service policies must, consistent with section 254 of the Act, ensure that wireless carriers have competitively- and technologically-neutral access to high-cost funding. Section 254 of Act also demands that such support mechanisms provide "specific, predictable, and sufficient" support that ensures consumers in high-cost rural areas have access to mobile wireless services that are "comparable" to those available in urban areas.[9]

The initial comments in this proceeding reveal a striking level of acknowledgement that mobility and broadband are the services that consumers are demanding today. Even many rural incumbent local exchange carrier ("rural ILEC") interests acknowledge the very strong consumer demand for broadband and mobility and the need to fund these services, which should be, but are not yet, ubiquitously available.[10] State public utility commissions and NASUCA also point out their constituent citizens' needs for broadband and mobility.[11] The Commission's reform efforts must be fundamentally driven by the need to ensure ubiquitous availability of mobile and broadband services. In light of these fundamental marketplace and technological realities, it is unsurprising that there is significant support in the record for the Joint Board's proposal to set aside universal service funding for areas where it is not economical to provide mobile wireless and broadband services absent support.[12]

[6] CTIA comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 2-11.
[7] *Id.* at 10.
[8] *See* Letter and Brief from Verizon and Verizon Wireless, in CC Docket No. 01-92, WC Docket Nos. 04-36, 06-122, at 6-7 (filed Sep. 19, 2008). *See also* Simon Flannery et al., *Telecom Services, Cutting the Cord: Voice First Broadband Close Behind*, Morgan Stanley Research (Oct. 1, 2008).
[9] *See* 47 U.S.C. § 254(b).
[10] *See, e.g.*, ITTA comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 8-9; KRITC comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 4-7; Montana Independent comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 17; OPASTCO comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 22; WTA comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 5-9, 22-23. *See also* USTelecom comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 24, 34; Rural Tel. Finance Coop. comments in WC Docket No. 05-337 (filed Apr. 15, 2008), at 3.
[11] *See, e.g.*, Connecticut comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 5; Oklahoma comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 17; NASUCA comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 21-22.
[12] *See, e.g.*, OPASTCO comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 21-22; NASUCA comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 11-13; WTA comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 3; TIA comments in WC Docket No. 05-337 (filed Apr. 16, 2008), at 1-2; CoBank comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 4-5; Connecticut DPUC comments in WC Docket No. 05-337 (filed Apr. 17, 2008), at 4-5.

Unfortunately, while the Commission appears ready to set aside between $3 and $4 billion annually for the extension of ILEC broadband networks, as a practical matter, no funding is being set aside for the extension of mobile wireless broadband networks. The Commission is now considering a mechanism to determine support for wireless ETCs that is not focused on making sure that wireless services are ubiquitously available, but rather is inexplicably intended to eliminate almost all universal service support for wireless carriers. Contrary to the FCC's tentative conclusion in the *Identical Support Rule NPRM*, the wireless ETC "actual cost" formula currently under consideration is neither based on wireless carriers' actual costs nor is it designed to direct appropriate amounts of high-cost support where it is needed. Rejecting another tentative conclusion, the Commission is considering a proposal to exclude spectrum costs from a wireless carriers' actual cost calculation.[13] Spectrum costs should be included in any determination of a wireless carrier's actual costs. Spectrum is a considerable cost of doing business for wireless carriers, akin to a LEC's loop costs.[14] As evidenced by the recent Advanced Wireless Services and 700 MHz auctions, wireless carriers are making considerable investments in spectrum assets in order to deploy the next generation, higher-bandwidth mobile wireless broadband services increasingly demanded by consumers. Just as it would be inappropriate to exclude a LEC's loop costs from determination of its costs, it is inappropriate to excluded wireless carriers' spectrum costs.

It is also our understanding that the draft order inexplicably would divide a *wireless ETC's* costs by the relevant *incumbent LEC's* switched access lines to arrive at the *wireless ETC's* average costs. Such a formula – which defies common sense – should instead divide a wireless ETC's costs by its number of subscribers residing in the relevant incumbent LEC's service area to arrive at a truer estimation of a wireless ETC's average costs.

Having determined a wireless ETC's average costs and comparing those costs to the relevant rural or non-rural incumbent LEC cost benchmark (strangely, instead of a wireless cost benchmark), the wireless ETC would still only qualify for the same support it currently receives under the "interim" CETC cap. In other words, the high-cost wireless ETC would receive no more support than it received under the cap, a result that in no way would reflect "actual costs." Further, those high-cost rural areas that do not currently qualify for support under the "interim" cap would remain unsupported.

The proposed "actual cost" formula would continue to penalize those rural consumers without access to mobile wireless services where they live or where they travel.[15] As CTIA noted in its comments, roughly 23.2 million U.S. residents currently lack broadband-capable wireless service at their primary place of residence, and more than 2.5 million miles of roads are not covered by a broadband-capable wireless signal (amounting to 42% of the road miles in the United States). A recently study conducted by CostQuest Associates estimates the total cost of completing the initial effort to construct a dual-mode 3G (Evolution Data

[13] *See High-Cost Universal Support: Federal-Sate Joint Board on Universal Service,* WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 08-4 (rel. Jan. 29, 2008) ("*Identical Support Rule NPRM*") at para. 17.

[14] If the Commission excludes spectrum costs, it should in fairness and consistent with competitive and technology neutrality principles exclude loop costs in ILEC support calculations.

[15] *See* CTIA Comments in WC Docket No. 05-337 and CC Docket No. 96-45 and accompanying study by CostQuest Associates, filed April 17, 2008.

Optimized ("EvDO") and High-Speed Downlink Packet Access ("HSDPA")) broadband-capable network in these areas at approximately $22 billion. This estimate does not include the substantial costs of operating, maintaining, and upgrading those same networks. The mechanism for determining CETC support that is currently under consideration by the Commission would not address these challenges.

Instead of pursuing another "illusory bandaid" mechanism such as is currently under consideration,[16] at the outset of a five year transition period, the Commission should seek comment on and develop a successor universal service mechanism(s) specifically designed to ensure the deployment and maintenance of advanced mobile wireless services in high-cost areas. As part of that proceeding, CTIA respectfully requests that the Commission give serious consideration to the establishment of two mechanisms: (1) One grant-based mechanism focused on <u>extending</u> advanced mobile wireless networks to underserved areas; and (2) One mechanism focused on ensuring that advanced mobile wireless services <u>are maintained</u> in objectively identified high-cost rural areas. Both mechanisms could determine support amounts, if any, based on objectively verifiable measures of actual cost. CTIA welcomes the opportunity to discuss these proposed changes with the Commission and any other interested parties.

Pursuant to Section 1.1206 of the Commission's rules, a copy of this letter is being filed via ECFS with your office. Should you have any questions, please do not hesitate to contact the undersigned.

Sincerely,

/s/ Paul W. Garnett

Paul W. Garnett

Chairman Kevin J. Martin
Commissioner Michael J. Copps
Commissioner Jonathan S. Adelstein
Commissioner Deborah Taylor Tate
Commissioner Robert M. McDowell
Daniel Gonzalez
Amy Bender
Scott Deutchman
Scott Bergmann
Greg Orlando
Nicholas Alexander
Dana Shaffer
Donald Stockdale
Al Lewis
Jeremy Marcus

16 *See* Dissenting Statement of Commissioner Michael J. Copps to the CETC Cap Order issued April 29, 2008.